VC Deal Structure: The Investment, Mechanics and Key Terms of a Series A Investment Agreement

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1. Introduction
2. Case Study – The Series A Financing Round at a Glance
4. Snapshot on Contractual Framework: IA vs. SHA
5. Parties to IA, Subject Matter and Applicable Law
6. Key Aspects in IA for Investors
7. VC Documentation, Recent Developments and Trends
Case Study – The Series A Financing Round at a Glance

Simplified overview

**Stock company**

IA = investment agreement
SHA = shareholders’ agreement

Flow of funds

Shares
Structure and Mechanics of Series A Investment

**FintechCo**
- Startup in financial services industry
- Stock company (e.g. Swiss stock corporation)
- Pre-financing: single category of (common) registered shares

**The investment by VC Firms**
- Direct equity investment into FintechCo
- Series A preferred shares

**Structure of Series A financing round**
- Capital increase (issuance of new shares)
- Investment and subscription agreement (IA)
- Shareholders agreement (SHA)
- Corporate documents:
  - Articles of incorporation
  - Organization by-laws

**Legal basis for investor rights and preferences**
- Corporate / securities laws (incl. articles, organization by-laws) and
- Contracts (IA, SHA)
# Snapshot on Contractual Framework: IA vs. SHA

<table>
<thead>
<tr>
<th><strong>IA – key aspects</strong></th>
<th><strong>SHA – key aspects</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>a)</strong> Terms of investment, equity structure</td>
<td><strong>a)</strong> Governance matters:</td>
</tr>
<tr>
<td><strong>b)</strong> Obligations of parties:</td>
<td>- Articles, organization by-laws</td>
</tr>
<tr>
<td>- <strong>Existing shareholders</strong>: implementation of capital</td>
<td>- Control, minority protection, important matters</td>
</tr>
<tr>
<td>- <strong>Investors</strong>: subscription and payment of committed</td>
<td>- Composition board of directors / management</td>
</tr>
<tr>
<td>- <strong>Company</strong>: ancillary undertakings (e.g. covenants)</td>
<td>- Information rights</td>
</tr>
<tr>
<td><strong>c)</strong> Conduct of business until closing</td>
<td><strong>b)</strong> Business related matters</td>
</tr>
<tr>
<td><strong>d)</strong> Closing, incl. conditions precedent</td>
<td><strong>c)</strong> Further financing</td>
</tr>
<tr>
<td><strong>e)</strong> Termination and rescission</td>
<td><strong>d)</strong> Capital structure, rights of shareholders</td>
</tr>
<tr>
<td>(e.g. preferences, anti-dilution protection)</td>
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</tr>
<tr>
<td><strong>f)</strong> Representations and warranties</td>
<td><strong>e)</strong> Exit provisions, share transfers</td>
</tr>
<tr>
<td><strong>g)</strong> Remedies</td>
<td><strong>f)</strong> Enforcement (e.g. liquidated damages)</td>
</tr>
<tr>
<td><strong>h)</strong> Confidentiality; nature of parties rights and obligations, etc.</td>
<td><strong>g)</strong> Term, termination</td>
</tr>
<tr>
<td><strong>i)</strong> Governing law, dispute resolution</td>
<td><strong>h)</strong> Non-competition</td>
</tr>
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<td></td>
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</tr>
</tbody>
</table>
IA – The Parties, Subject Matter and Applicable Law

Parties to the IA

(1) Investors
   - (foreign) VC Firms (e.g. in the form of LLPs or other investment vehicles)

(2) Existing shareholders
   - Founders
   - F&F investors
   - Business angels

(3) The company (FintechCo)

Subject matter of IA

- Financing agreement
- Main obligations
  - Investors: Subscription and payment of committed amounts for new series A pref. shares
  - Existing shareholders: Waiver of preferential subscription rights, procure resolutions of shareholders and board of directors, implementation of capital increase
- Ancillary obligations
  - Existing shareholders: Representations and warranties, covenants, etc.
  - FintechCo: Confidentiality, conduct of business

Cross-border setting; applicable law

- Interplay between IA / SHA and (mandatory) corporate law framework
Funding approach and commitment by VC Firms

(1) Funding in one tranche (one closing) OR
(2) Funding in several tranches (multiple closings, milestone approach)

Milestone funding approach

- Purpose
  - Investment control
  - Incentivise the management

- Mechanics
  - Staggered investment
  - Funding in tranches subject to achievement of milestones

- Milestones
  - Objective measurable criteria
  - Decision on achievement
    - Investors
    - Board of directors of FintechCo
    - Independent expert

- Staggered legal implementation
  - Multiple capital increases OR
  - Staggered payment of issue price for shares (partial «paying-up») OR
  - Subsequent contributions to reserves
Key Aspects in IA for Investors – Closing of Investment

Conditions to closing
- Availability of all required documents for closing
  - Capital increase
  - Corporate changes (e.g. board change, appointment of auditors)
- No breach of IA
- No material adverse change (MAC)
- Specific requirements (e.g. consents from third parties, fulfillment of milestones for tranches)
- Bring-down certificates (e.g. reps/warranties)

Closing and post-closing
- Place and date of closing
- Closing of IA: closing actions and deliverables (incl. SHA)
- Local law formalities / capital increase (e.g. involvement of notary public, deposit of funds)
- Registration of capital increase (e.g. public commercial register)
- Issuance of shares and updating of share register of FintechCo

Termination and rescission
Key Aspects in IA for Investors – Representations and Warranties

**Purpose**
- Allocation of risks
- Bridge information asymmetry
- Obtain additional information, disclosures
- Differences: VC transaction vs. M&A deal

**Representations by existing shareholders**
- Expectations of investors >> standard set of reps/warranties
- Who is best positioned? >> Founders vs. F&F investors vs. BA?
- Appropriate solutions?

**Representations by Swiss company (FintechCo)?**
- Nature of equity investment
- Corporate law restrictions
  - Prohibition of return of capital
  - Unlawful distribution of profits

**Representations by investors**

**Exclusive representations and warranties**

Diagram:
- **Representations for investors**
  - **Existing Shareholders**
  - **VCs**
  - **Investors**
  - **F**
  - **BA**
  - **F&F**
  - **FintechCo**
- **Feasible?**

Definitions:
- **VCs** = VC Firms
- **F** = Founders (and managers)
- **BA** = Business angels
- **F&F** = Family & friends
Key Aspects in IA for Investors – Remedies

Remedies
- Right to remedy / cure
  >> To put company and/or investor(s) in a position as if no misrepresentation or breach had occurred
- Indemnification / payment of damages
- Transfer of shares from existing shareholders to investors
- Staggered remedy concept

Limitations
- Time limitations (notice of breach, limitations on claims)
- Limitations on liability
  - Liability cap
  - Disclosed matters (e.g. fair disclosure concept)
  - Other limitations (insurance coverage, provisions, etc.)

Remedies exclusive

Practical challenges
Key Aspects in IA for Investors – «Boiler Plate» Items, Drafting, etc.

«Boiler plate» items

- Nature of parties' rights and obligations
  - Several, not joint, except as otherwise set forth in IA
  - Investors may exercise and enforce their rights individually
  - Obligations of contractual nature, no simple partnership
- Costs, expenses, taxes
- Choice of law, dispute resolution

VC documentation

- Expectations of parties
- Alignment on VC standards / typical deal terms
- Use of model documentation for VC investments (as starting point)
- Allocation of drafting responsibility (!)

Recent developments and trends
Franz Schubiger is a partner and member of Pestalozzi's Corporate / M&A and Life Sciences Groups in Zurich. His practice focuses on corporate law, M&A, corporate finance, private equity and venture capital, complex restructurings as well as general contract and commercial law. He regularly advises in the fields of life sciences, including pharma, consumer healthcare and medtech, as well as consumer goods and retailing industries, e-commerce and online business.

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